RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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Post Office Box 1759, La Jolla, California 92038

26 Letters Per Year • $250 annually

Sept. 18, 1991 **LETTER 1078**

THE MARKET: From a technical standpoint, the most important market development is this: the D-J Transportation Average continues to trace out a pattern of declining tops -- 1251.76 on June 4, 1227.08 on August 1, 1215.44 on August 23. In other words, the Transports are in the process of sinking out of sight on the downside. This is not a good omen.

What this means, from a Dow Theory standpoint, is that any forthcoming rally in Industrials, even a rally to new record highs above 3055.23, would almost surely not be confirmed by the Transports. And there is a limit to how long a string of non-confirmations will continue before trouble arrives. The longer the period of divergence (i.e., a series of non-confirmations), the nearer the market is to trouble.

As I see it, the stock market has been "living" off the fed-manufactured decline in interest rates. As the recession wears on with few convincing signs of a real upturn (despite the parade of happy predictions out of Washington), pressure continues on the Fed to ease again and again. Thus, as far as the stock market is concerned, the sluggish, no-growth economy provides the bad news, while at the same time, declining interest rates provide the good news.

The stock market seems convinced that at some point declining interest rates will be the spark that will set off a definite upturn in the economy. Will it happen? That's the number one question on Wall Street and every other street.

But why guess? Why dwell on every scrap of news and every rumor about the economy? The real question is not whether the Fed's manipulations can turn the recession around. The real question is this -- **Is the primary trend of the market still bullish, or is the primary trend in the process of turning down?** IF the primary trend is still bullish, then in due time (by definition) BOTH the D-J Industrials and Transports will advance to new all-time highs. But IF the primary trend has turned bearish, then regardless of any rallies, we are not going to see new highs in the two Averages (the Dow alone may go to a new high above 3055.23, but the Transports will not confirm -- or Transports alone may go to a new high and the Dow will refuse to confirm).

Let's take it further -- if the great primary trend of the market has turned bearish, then the Fed can take interest rates down to zero, and they still won't be able to turn the market or the economy around. Conversely, if the primary trend is still bullish, then the Fed can sit on its hands and in due time the recession will give way to good times again.

A short-term consideration is this: on September 4, the Summation Index (based on the interaction of two exponential moving averages of breadth) gave a sell signal. One of the tests I use for gauging market strength or weakness is based on what happens to the averages during buy modes and sell modes in the Summation Index.

Any time the Summation Index is declining, it's in its sell mode. So it will be important to see how much damage the market will now be subject to, since the Summation Index is currently bearish.

Sept. 6 DJIA 3011.63; PTI 3360; A-D Ratio -10.84
Sept. 13 DJIA 2985.69; PTI 3360; A-D Ratio -11.20
Dow Yield: 3.07%; Dow P/E: 22.9; DowPow: 35
Dow 200-day MA: 2867; Dow 30-day MA: 3016
Dow Book Value: 1331; PTI 89-day MA: 3321
Percentage of Undervalued Blue-chips: 11%
Stock Summation Index: 1522 (Bearish)
Bond Summation Index: -61 (Bullish)

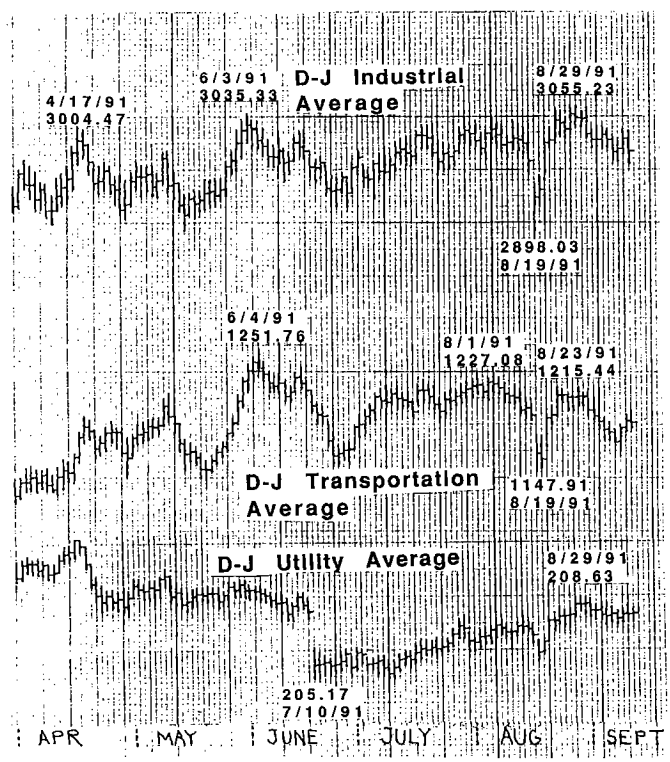
Longer-term: the Averages are definitely out-of-gear and the Summation Index is in its bearish mode. What about my Primary Trend Index (PTI)? It's still bullish as noted in the following discussion:

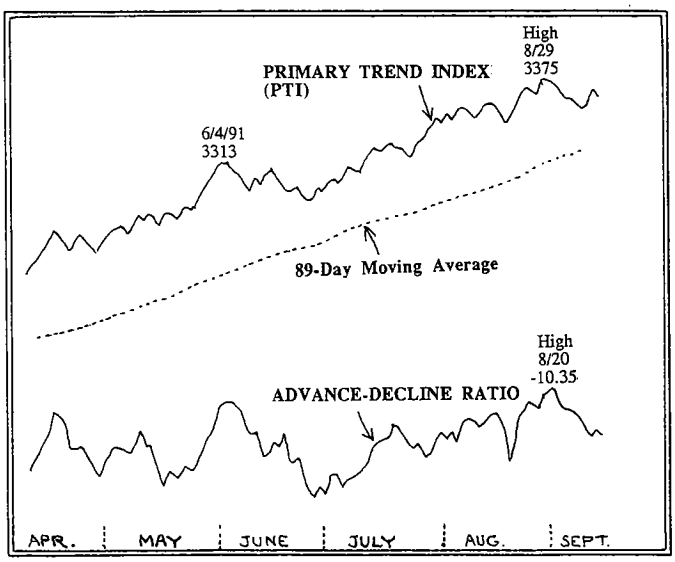
PTI: I have often stated that the PTI doesn't have a brain, but even without a brain it's smarter than I am. Consequently, I'm revealing no secret when I tell you that I have many subscribers who read what I say for information (and even for amusement), but who base their investing strictly on the action of the PTI.

And no, that doesn't embarrass me. But it often presents a very difficult path for me and for those who follow the PTI. It's difficult because most investors demand reasons before buying or selling, and the PTI doesn't provide any reasons. The PTI moves strictly on the technical undercurrent of the stock market, and more often than not what the PTI "sees" is not apparent to the casual observer.

I invented the PTI back in the late-1960s. I put it to the test for three years before introducing it in the Letters in 1971. Since 1971 I have included a chart and statistics for the PTI in each and every report.

The reason I developed the PTI was as follows: during the 1960s an increasing number of analysts and market letters appeared on the





Wall Street scene. With them came an ever-increasing number of new techniques and devices. Everybody followed a favorite stock market cycle or had a theory or device for beating the market. A new indicator would be described in *Barron's* and suddenly half the analysts in the nation would pounce on it. In this business, too many cooks invariably spoil the broth, and too many analysts following the same techniques tend to render that technique useless (remember the Confidence Index, Will-Go, the odd lots, the short interest ratio, etc.?).

I felt that I needed an indicator that was "outside the system." I needed an indicator that was not being followed by everyone on Wall Street. Furthermore, it had to be an indicator which was based on market action. I wanted it to be based on the actual technical undercurrent of the market rather than on subjective observations such as bull/bear sentiment or contrary opinion.

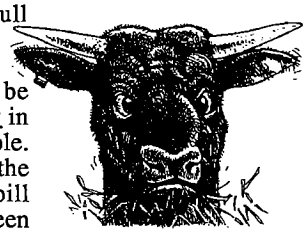
The device I finally arrived at was what I called my Primary Trend Index. This Index was made up of eight components, and all eight were absolutely crucial in measuring the strength (or weakness) and the direction of the market. The daily measuring and weighting of these eight components comprised the PTI. A chart of the PTI together with the daily advance-decline ratio appears on page 2 of each and every Letter.

Current Situation: The PTI turned bullish on January 31 of this year. And it has remained bullish ever since. I grade the PTI in two ways. (1) On a nearer-term basis, I simply draw trendlines where applicable. If the PTI is trending down but still above the moving average, this is a warning signal. As you can see via the page 2 chart, the warning signal is now in force. (2) I depend on the 89-day moving average (MA) of the PTI to provide major buy and sell signals. When the PTI is above its 89-day MA, the bull is in command; when it's below its 89-day MA, the bear takes over.

The bull signal given by the PTI on January 31 is still intact. It will remain in force until such time as the PTI breaks decisively below its 89-day MA.

DISTRIBUTION: The first six months of 1991 saw an all-time record of $27 billion in new stock issues and secondary distributions. Judging by the type of new funds being brought to market, the royal road to riches today would seem to lie with "emerging growth stocks," "small capitalization stocks" and bonds. A new fund specializing in one of these categories seems to come out of the woodwork every other day. And the lineup of mutual funds listed in your daily newspaper is (absurdly) beginning to stretch out towards infinity.

INVESTMENT POSITION: Despite my trepidations, the bull remains in the box.



However, the following might be noted: The degree of complacency in the markets is now truly remarkable. For instance, the TED Spread (the Eurodollar yield minus the T-bill yield) is the lowest I have ever seen it. There's a mere 0.55% difference between T-bill yields (bearing the full faith and credit of the US government) and non-guaranteed Eurodollars of the same maturity.

The cash position of the funds is now 4.7%, the lowest cash position on record. What does this mean? It means that the funds are now positioned for a big stock market move on the upside. Will they get their big move? Does the market always oblige? Well, sometimes, but more often than not it frustrates.

Meanwhile, the earnings yield on the Dow (Dow earnings divided by Dow price) is a very low 4.29%. This is well below the guaranteed 5.47% yield on T-bills. Normally, the earning yield on the Dow should be at or above T-bill yields. Conclusion: at over 3000, people are paying "through the schnozola" for Dow earnings!

As for the Dow dividend yield, it is down to 3.1%, a level commensurate with many past market tops. As I've been saying, from this point on it's simply a question of "How hot is hot?" Answer: no one knows.

Meanwhile, everybody wants income. I continue to feel that over 5% on short-term Treasury debt isn't a bad deal. I remember during the 1950s when the Treasury came out with long bonds at 5% (the "Magic Fives") people thought it was a gift from the gods.

My old friend, Jim Blanchard, has what he calls the Blanchard Short-Term Global Income Fund. The fund pays a current 10.1%. Its average maturity is 22 months. Its current top positions are 15% in Canada, 17% in Italy, 19% in Spain. With the dollar falling through support and looking weak, this fund is interesting (I hear it's up over half a billion dollars). For more info call (800) 922-7771. By the way, I never make a nickel on a securities recommendation.

The newspapers are chock full of ads for tax-free funds, high yield funds, fabulous income funds. Before you go for it, check what's in those funds. Check management fees. And pay no load.

DEBT: The federal deficit for next year is scheduled to be $360 billion (Ed Hyman thinks it may be as high as $380 billion). That's outrageous, but do you know what's even more outrageous? In the coming fiscal year our government will take $63 billion from the Social Security Trust in order to pare down the deficit. Thus, the true deficit will not be $360 billion, it will be $423 billion.

Furthermore, instead of building up assets in the Social Security system, money that should go to the Social Security Trust is being applied against the deficit to cover our government's over-spending. If you or I or any corporation operated in this fashion, we'd be slapped into jail and tried as felons. It's thievery, and it's ridiculous that we allow "our" government to get away with this kind of embezzlement.

So the deficits and debt continue to mount, and idiotic defenders of the deficits continue to tell us that "we just owe it to ourselves" or "deficits don't matter" or "the deficits are just a minor percentage of GNP" or "deficits are stimulative and actually good for the economy" or "we've had deficits for decades, and hey, aren't we still a super-power?"

If you ever hear anyone mouthing that kind of nonsense, just show them a long-term chart of the dollar. Or show them a chart of the trend of American living standards. It's so obvious. If you continue to spend far beyond what you earn in income, then something has to give. Since we run up our debts in dollars, so far it's the dollar that has "given." But as the dollar sinks into the sunset, it buys less and less in the way of imports. And since America is living high on imports, we either have to pay more for those imports (and that's inflationary) or we have to do without those imports (and that's a lowered standard of living).

Furthermore, as the world perceives the trend of America's compounding debt, the world will become increasingly suspicious of the dollar. Finally, the world will actively try to cash out of dollars, and that's when the BIG trouble begins.

For a time, I felt that there was an easy answer to the US insanity of running huge deficits. The answer was simply to cut back drastically on government spending. But today this nation depends so much on deficit spending that to cut back that spending would throw the nation into a depression. So today, I don't see any easy and obvious answer. But the markets will provide the answer. The answers will show up in the price of stocks, bonds and the dollar. And the answer will also show up in the trend of America's living standards.

Ah yes, there is one thing we can do. I'm convinced that we must put limits on terms of office for our Congressmen and Senators. These men are for the most part obsessed with remaining in office, and they feel that the path to incumbency is to spend for their constituents. So here's what limitation would do. It would tell these people, "Look, you might as well think of the nation. You're going to be out in eight years, and no amount of spending is going to keep you in office. So act like a statesmen instead of a politician. You've only got eight years to do something useful for your country. Do it." And yeah, limitation will mean that we will lose some good people. But it will be worth it, believe me.

SOLUTION? I guess I've been watching the debts and deficits for too long. Maybe there is a "solution." Malcolm Berko, a registered principal of the NYSE and member of the Commodities Futures Trading Commission writes this in answer to the debt and deficit question (and I think his answer is important because it's undoubtedly the way Washington is thinking):

"Since it's not polite to raise taxes or cut spending, the sole remaining solution is inflation -- the only form of taxation that doesn't require a congressional vote. Here's the possible scenario.

"Now that the reappointment of Fed Chairman Greenspan has been agreed upon, the Fed will begin to print new dollars to double the money supply by 1996. That's an important date because 1996 is another presidential election year. The Fed and the White House will try to ease credit and jaw-bone long-term interest rates down to a 6% level. The money supply will start to increase much faster than the production of goods and services and create a demand-push inflation as these dollars compete for fewer goods.

"As banks become flooded with deposits, interest rates will drop, credit will expand and stimulated consumer spending will dramatically increase prices. As the money supply continues to accelerate, prices of goods will reach an equilibrium to reflect the amount of new money in the economy. Therefore, as the Fed continues to print and force-feed money into the economy, real estate prices could easily double by election time in 1996. This would take enormous pressure off the banks and insurance companies as real estate prices move above the levels reached during the Nancy Reagan administration.

"The monetary infusion would smartly buoy the junk bond market and take all the remaining pressure off banks and insurance companies, returning them to the former glory of the mid-1980s. Consequently, construction employment would climb, and the entire building products industry, including appliances, carpets and furniture would boom anew. As employment climbs, more people earning incomes create an increasing demand for goods and services, which will create more manufacturing jobs employing more people and exponentially increasing the nation's personal and business incomes. As incomes increase, the government tax revenues will increase by orders of magnitude. As the government restrains spending, it will use its dramatically increased income to eliminate the deficit and reduce the debt."

Russell comment: There you have it, the secret master plan to turn a recessionary US economy around and to create a new boom. But note the Berko scenarios depends on a massive increase in the money supply and a huge rise in inflation. Will this be allowed? Can it happen? Will Greenspan go along with it? Will Paul Volcker keep silent? And what happens when inflation heats up and gold moves over 400, then over 500? Will Kondratieff be pronounced a dead theory? Will the Fed be able to put off bear markets for years, maybe for decades? And is all this why my PTI continues on its bullish path, despite the recession?

Another thought: will the Fed be able to boom the money supply if the American consumer continues to sit on his hands? And will business want to borrow if the consumer doesn't want to spend? During the 1930s money rates went down to almost zero, but people still refused to borrow. The psychology was wrong, a thick gloom enveloped the land. Was that gloom part of some cycle? Or was it a once in a hundred years phenomenon? Is the human psyche or the cycle of human sentiment different today? All of these are question without answers.

The Zen master said, "One fool can ask more questions than ten wise men can answer." Am I asking too many questions? I better stop. Let's just watch the trend of the PTI.

NOTES & QUOTES: How do you explain the mad desire of presidents to be elected for a second term? I can't figure it, because by the end of the second term most presidents look like hell, and I'm sure the pressure shortens their life. But that doesn't stop George Bush. So what's Bush's worst nightmare? It's this -- a continuing and very possibly worsening credit crunch. The credit crunch is being caused by over-extended banks, loaded with bad debt, trying to get liquid and beset by federal regulators. One guy who is worried about the situation is Commerce Secretary Mosbacher. Recently he said, "I saw this (credit crunch) happen in Texas. We can't let it happen nationally." He added, "It's not just developers who are affected, it's small and medium-sized businessmen and manufacturers, the people we need to get some growth back into the economy." A thought -- only twice in the postwar period has a recession occurred in years divisible by four, and both times they spelled defeat for the party in power.

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Squeeze: Hollywood's summer has been a bummer. Theatres have taken in 25% less this year than last. Movie industry's profits are down 25%. Costs of making movies have doubled in the last 10 years. Things to come: COST CONTROL. Huge star-salaries will be history. Low budget movies will be in. Russell opinion: Next victim -- those huge sports salaries. Timing: After the TV contracts come up for renewal.

* *

What constitutes true power in Hollywood? It's the ability to say, "This movie will get made." Highly successful actor-director, Danny De Vito was recently interviewed in the *NY Times*. Question: "Can you get anything made you want to now?" Answer: "Yes." Question: "Either as an actor or a director, if you say yes the movie gets made?" Answer: "Yes." Question: "How does that make you feel?" De Vito's answer: "Glorious."

* *

Peugeot and Sterling have dropped out of the very tough US car market. Rumor is that Porsche will exit next. The Japanese are moving increasingly into the luxury (over $20,000) market -- and they're hurting the Europeans. In 1987 Europeans had 32.1% of the US luxury market. So far this year they've dropped to 19.8%. Mazda now announces that it will be in the luxury market in 1994. The Japanese are bent on taking over this lucrative market, and so far they're doing a bang-up job.

* *

Watch Out George: California's Jerry Brown has decided -- he's running for president. Says Brown, "I'm lean and frugal and low to the ground. I'm broke and in trouble. And that is why I am just like America." Mmm, he may have something.

* *

Two things I've always wondered about. You go to the downtown sector of any city in the nation and what do you see? T-shirts, in every store, in every window (and to think that Marlon Brando started it all, in "A Streetcar Named Desire"). And I've wondered, how many T-shirts are sold in the US every year? Answer (according to *New Age Graphics*, the trade magazine): 1.8 billion T-shirts a year. Can you believe it?

A second wonderment: mutual funds are now coming out of our ears. But how large an investment does the average American have in funds? Anyone know the answer to that one?

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Last week the *American Bankruptcy Institute* predicted that 1991 will see a record 1 million bankruptcies (business and personal), with emphasis on heavy filings in shellshocked New England. But oh no, not this: Last week saw *International Broadcasting Corp.* file for Chapter 11 bankruptcy. IBC owns the fabled Harlem Globetrotters and the Ice Capades.

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The stock market (historically) does not like excesses. Here are two excesses -- there are now 3,200 mutual funds in the US, or more funds than different stocks on the NYSE. If that isn't an excess, I don't know what is. Also, currently, there are over 500 different market letters being published (when I started in 1958 there were about six). So that's another excess -- Russell prediction: within the next five years mutual funds and market reports will be decimated.

* *

A potential huge problem is that the earth's population is growing geometrically. When rats are crowded in a cage, they go beserk and start killing each other. Is that what's happening in the human world today? I believe that to some extent it is. There are now 5.5 billion people on earth. If they were all crowded together and each was given a space two feet by two feet the result would be a mass of humanity covering less than 800 square miles (roughly the size of the city of Jacksonville, FL). It doesn't sound like much does it? But the problem is that so many of those 5.5 billion people live in limited areas, particularly large cities. My own opinion is that somewhere along the line the world has to put a stop to the population boom or else some natural or man-made calamity will halt the exponential rise in the world's population.

* *

From *Strategic Advisors Corp.*: "Judging by the patterns of the past, the world economy has already entered the early stages of depression. Unless there is convincing evidence of a sustained recovery soon, you should expect a second and more serious stage of the credit crunch. The logic of this is very simple. The average interest rate in the US is above 10%. On personal loans the average is 15%. For many marginal borrowers, issuers of junk bonds, LBOs, consumer credit card borrowers, etc., the interest is compounding at even higher rates. But the nominal growth of the economy over the past six months has been a measly 1.7%. The interest burden is compounding 5-6 times faster than the economy is growing."

* *

Industry Forecast (Box 27, Chappaqua, NY 10514) is one of the oldest and best economic forecasting reports in the business (they've been publishing for 43 years). Here's what they're saying: "*Industry Forecast* has distinguished between a recession -- an adjustment to short-term overproduction -- and a depression -- a much longer and more serious adjustment to long-term over-investment in fixed assets. Based on this definition, America is clearly in a depression, but the damage is and will continue to be contained by the stabilizing effects of heavy federal spending and government safeguards on the financial system, notably deposit insurance. Thus we have dubbed the 1990s' malady a 'contained depression.' The economy's slow, painful deterioration during 1989 and up to the recession's start, despite falling interest rates, was a symptom of a developing slowdown in fixed investment, a fundamental depressionary development."

* *

An article in the *LA Times* (Sept. 1) starts, "Marilyn Monroe. . . Of course, everyone knows who she was. It is a name better known around the world than the Virgin Mary." Well, readers, here's a story I've never told. When last I lived in NYC I resided at 125 East 93 St. Marilyn Monroe was married to Arthur Miller at the time, and she was going to a woman psychiatrist whose office was on 93 St. just across Lexington Avenue. I used to see Miss Monroe walking to her therapist every Wednesday at 8AM. She would dress very plainly and always covered her head with a scarf. After her session, (at 9AM) Monroe would stop for a cup of coffee at a little coffee shop on my corner. Bold adventurer that I was, I decided that I would like to meet her. So one day I looked out my window at 8:50 AM, and up the block came Marilyn Monroe and into the coffee shop. I rushed downstairs, entered the coffee shop, and sat at the counter, two seats from Miss Monroe. I ordered a cup of coffee (there was no one else in the place) and stared at my cup. Finally, summoning up my chutzpah, I turned to Miss Monroe and said, "Aren't you Marilyn Monroe?" She looked very flustered, turned to me and said, "No, I'm not." I was so taken aback by this denial that I gulped, "Oh, excuse me, I thought you were."

I've often looked back on this and mulled over my stupid approach. I embarrassed the lady, and she obviously did not want to talk to a stranger, particularly after she had just come from a therapy session. And that, readers, was my strange and embarrassing encounter with Marilyn Monroe. A few months later, sadly, Marilyn Monroe committed suicide.

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The top financial policy maker for the world's largest creditor nation is Tadao Chino, Japans' new finance minister (he's a Stanford graduate). "Back in my Stanford days," says Chino, "the US was the model of success that Japan had to learn from." But Chino now takes a far different view of the country he once idolized. Chino indicates that Japan will become much more assertive in pushing its financial objectives with the Group of Seven and in its trade negotiations with the US. According to Chino, Japan will increasingly use its aid as seed money to attract Japanese manufacturing. Japan will encourage more developing countries to adopt economic policies similar to Japan's, in which the government works closely with industry to increase exports under the shield of large Japanese corporate groupings. Chino insisted the *keiretsu*, Japan's grouping of industrial companies, has many positive features, and that Japan will adhere to *keiretsu*, regardless of US objection.

* *

Expenses: It is now estimated that the removal and coming trial of Manuel Noriega will cost taxpayers roughly $200 million, $163 million for the invasion of Panama and $25 to $40 million for the coming trial. Was it worth it? Hardly, there are more drugs coming through Panama now than before. But look at it this way: $200 million is only 20% of a single day's deficit in the US. Hell, at that rate,we could have five mini-invasions a day.

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Now that the Soviets have come unglued, our military and our spy organizations are going to have an increasingly difficult time justifying their expenses -- $300 billion for the military and roughly $30 billion for the CIA. If the Soviets start de-militarizing in earnest (and I think they'll have to) the US won't have a legitimate major enemy on earth. Which means that before long there'll be major pressure to cut down our military and intelligence-gathering expenses. Said Samuel Wilson, former head of the Pentagon's Defense Intelligence Agency, "All my pillars of intellectual support are pretty well gone, because the Soviet Union and Soviet forces as I knew them no longer exist." All right, won't the coming military cuts help the federal budget? Forget it, the money will be spent even before the cuts are made.

* *

My complaints about the idiotic, hostile, anti-wealth and anti-business policies of the California authorities evidently hit a nerve among subscribers, and I have received dozens of letters agreeing with my stance. Here's a section of a typical letter from a ten-year

subscriber out of Palo Alto. "My wife and I are going to move out of California soon, probably to Austin, Texas. I'll be damned if I'm going to stand by and let bureaucrats take our hard-earned and thoughtfully invested money and use it to destroy what I love about California, and then use what's left to feather their own rather fancy nests. If you want my money, pal, EARN IT, like the folks at Apple, Microsoft, Matsushita or 20th Century Industries. I have lots of hard-working years left as does my wife, but we'll be putting our resources and work elsewhere." Russell comment: Yep, a lot of Californians are fed up, and they're voting with their moving vans.

* *

The news is getting out. Because of the new communications capabilities, you can move anywhere and run your business. And that's exactly what's happening. Corporations and individuals are moving out of the smog-filled, crowded, crime-filled, high-tax cities, and they're moving to small towns all over America. My opinion -- the exodus is just beginning. And it's going to kill the tax bases of many cities. Warning: it's also going to put many municipal bonds in jeopardy. And the higher the cities, counties and states boost taxes, the greater incentive there will be --to MOVE.

* *

Does any thinking person trust government statistics, particularly prior to a major political election? John Liscio in *Barron's* (Sept. 2) notes that in July's big 1.2% gain in the leading indicators, 1% of that gain was due to the huge 11.2% rise in the durable goods orders. But durable goods orders actually declined in July, the big leap upwards was the result of a seasonal adjustment factor.

* *

Hollywood being in LA, the *LA Times* gives more news and coverage to the film industry than does any other newspaper. In the Sept. 2 issue, the front page article states, "Film Industry Reeling Under Profit Plunge." The article goes on to talk of "an industry wide slump, as plunging profits and feeble ticket sales have sent the dream factory into what some see as its deepest downturn in 20 years." On the same day, the *NY Times* featured articles on the slump in the publishing industry, including books, magazines, newspapers and advertising. The gist of the articles is that the industries are cutting out expensive promotions and also cutting back on expensive productions. For instance, the *LA Times* states that "at Universal Pictures, the party's over. The studio has decreed that it will no longer pay for the elaborate premier parties that are a staple of the Hollywood social scene."

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I continue to believe that the trend of California real estate will be one of the keys to the US economy. Here's an interesting quote from Jerry Jordan, chief economist of First Interstate Bank: "Commercial real estate buildings are coming up like asparagus in Los Angeles, but US banks did not finance them. I expect the vacancy rate, which was 16% a year ago, to go to 32% by the end of 1992. But they have been financed by Japanese banks or insurance companies."

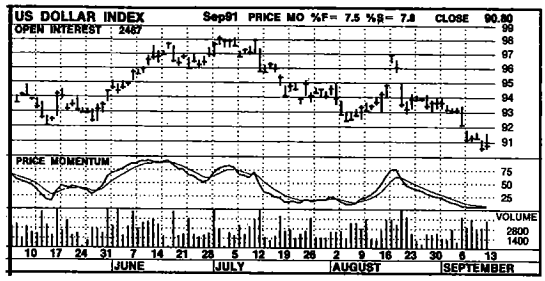
* *

Gosh, what happened to all that victory news about Iraq? Oh yeah, the Soviet news pushed it off the front page and every other page. Well, here's some news. Saddam is telling Iraqis that they won the war, and last week Saddam passed out "Victory" medals to all those who participated in the "Mother of all Battles." George Bush, are you going to stand for this?

CHARTS: "Get the rates down, get the rates down!" That's been the cry on Wall Street for months. And the Fed obliged again September 13, cutting the discount rate another 1/2%, bringing it down to 5%. When rates come down: (1) The banks do better, since they pay less for money -- and in today's case, they lower their own lending rates slowly and reluctantly. (2) The public does worse, since their savings (at lower rates of return) provide them with fewer dollars. (3) The dollar does worse. Since this is a global world, what international money would want dollars when they can get a much fatter return on D-marks or Swissies or Lira or Pesetas?

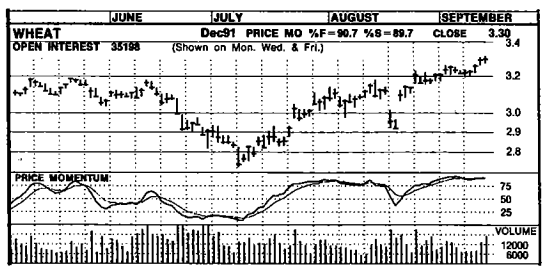
Last week I called up my friends at the big Swiss Bank Corp. and asked them what they thought of the dollar. They said they still liked the dollar, and they felt the unstable Soviet situation would impact on the Deutsche mark and other European currencies. They asked me what I thought. I told them I thought the dollar looked like hell.

On Sept. 12 the Dollar Index (Dec. contract) broke below the neckline (support) of the big head-and-shoulders top it has been forming. Not a pretty picture (chart courtesy of *Investor's Daily*). As far as I can see, the dollar is now in a confirmed bear trend. I've warned about the dollar in recent Letters. "If the December Dollar contract breaks 92," I wrote, "the ball's in the bear's camp." On Sept. 12 the Index broke below 92.



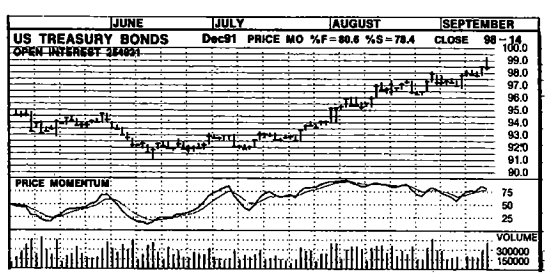
Meanwhile, the yen bottomed in June and the mark bottomed in July. Swissie and the rest of the European currencies have pretty much followed the mark.

The commodity types are excited about the *grains*. US stocks of most grains are at eight year lows, and the Soviets are going to have a bad winter (25% of their grain crops rot because they don't have any place to store them). The Soviets are now asking for huge grain imports. Clearly, the meats and grains have all put in their lows, and higher prices should lie ahead. And if that's so, the CRB Commodity Futures Index should soon be heading up, and so should food costs in the US.



A few economists talk of a "double dip" recession, while government economists and spokesmen tell us the recession is history. My opinion is that it's a "single dip" recession, and as far as I can see we're still dipping. Greenspan says everything is all right and that the recession is over -- but if it's over why is Mr. G. still dropping the rates?

Treasury bonds continue to climb higher, spurred on by an anxious Fed, and also by the public's almost hysterical demand for yield (income). Bulls on bonds (even though bonds are overbought here) are talking 7.5% and even 7% yields on the long bond. I run the

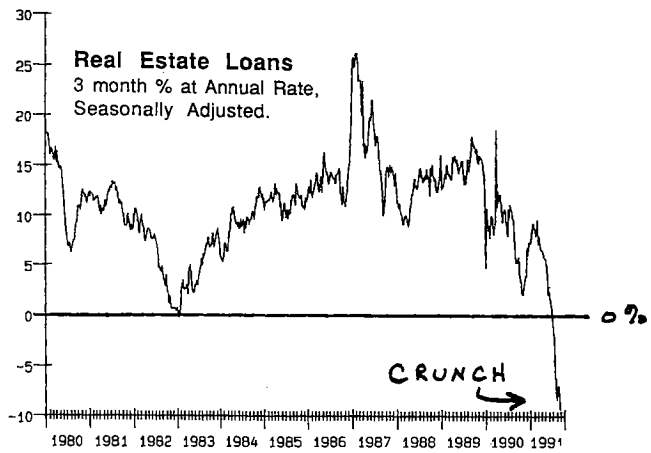


Summation Index, based on advances and declines on the NYSE Bond exchange. The Bond Summation Index turned bullish on July 11, and it's been bullish ever since. Figures on the Bond SI will be shown (from now on) on page 1. As long as the SI figures are rising, the trend in bonds will be labeled bullish.

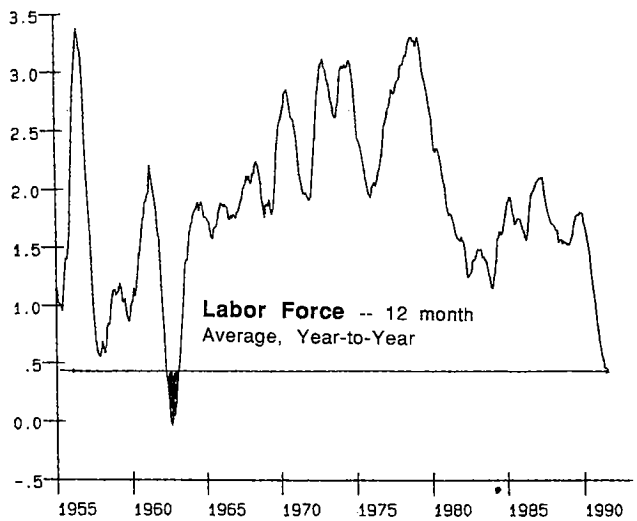
What's the meaning of a sinking dollar? For one thing it means that our foreign creditors will be getting very, very nervous about their dollar holdings. And it means that US travelers in Europe and Asia will be facing prices they are not going to believe.

It is said that until car buying and home buying picks up, this nation will still basically be in a recession. Well, car buying is still on its back. Personally, I think the car manufacturers are pricing cars out of the reach of most consumers. They're suffering from "sticker shock," or "showroom paralysis" or whatever you want to call it. For the third quarter, the big three US auto makers are slated to lose about $1.4 billion.

Ed Hyman and Nancy Lazar (*International Strategy and Investment)* in their latest report show this chart of Real Estate Loans (3 month % as annual rate, seasonally adjusted),and their comment is "Crunch." They add, "Due to pressure from regulators, higher mortgage delinquency rates and less enthusiastic demand, Bank Real Estate Loans are declining sharply. Housing starts . . . could slip below 1.0 million units this fall."



To my mind, the real crux of this recession has to do with jobs, employment, the labor force. Here's the latest *ISI* chart of the Labor Force on a 12-month average, year-to-year basis. The trend has dropped to its lowest level since 1962.



Everyone in the nation now has a neighbor, someone on the block, who is out of work. When your neighbor is jobless, it makes you think. And it slows you down on buying that new car or new home. We can certainly see the trend here in San Diego, where our morning paper (*San Diego Union*) and our evening paper (*Tribune)* have just announced that they will merge. Result, a single paper in San Diego and a lot of people losing jobs and many having to move. It's sad -- I hate to see any newspaper close down, and I hate to see friends get pink slips. Newspapers constitute one of the basic foundations of a free people. When a newspaper goes under, it's a tragedy for the news people and their readers.

GOLD: The precious metals picture is becoming kind of interesting. *The Bullish Review* [(618) 423-4949] monitors the big commercial interests and the smaller speculators' positions in the various contracts. In their latest FAX they note, "Commercials added 11,000 (gold) long positions to move to a record +40% net-long position at the contract lows on Aug. 30." The *Review* also notes, "One-third of the weak speculative short positions are held at prices below 368 (Dec. contract) and will provide substantial short-covering fodder on the first sign of positive price movement. The current quiet market conditions have the earmark of the 'calm before the storm' and mask the extreme market imbalance we are privy to."

In other words, the big boys (commercials) are heavily long gold and the smaller more speculative element is heavily short. Add to this the phenomenal public and Wall Street bearishness towards gold and you have a most interesting situation

It is also not unusual -- when you have a lop-sided technical situation such as the current one in gold -- to have one final downside cleanout (a bear trap). Well, we certainly have that (with gold in the 340s).

With the federal debt surging and out-of-control and a continuing recession, the dollar is now coming under attack with the help of much higher European rates. The Europeans have stopped buying dollars. Furthermore, the ruble has dropped to the point where it is almost worthless (barter is taking over in the Soviets). I believe that the Russians are nearing the point where they will have to halt their sales of gold. What would make real sense is for the Russians to back the ruble with gold, making it fully convertible, and thus establishing the ruble as a currency that has some value. Of course, the US wouldn't take kindly to any Russian move to back their currency with gold.

If gold does move up, it will be a sign of one or more of the following: (1) the US economy is in deepening trouble, (2) the Fed is moving towards still lower rates (although I believe with the latest discount rate cut that they have gone as far as they can go), (3) inflation is on the way back, (4) there is some kind of major trouble brewing, either with the dollar, the banking system, or elsewhere, possibly in Russia.

At any rate, let me put it this way. The last thing in the world the Administration or the Fed wants to see is gold rising, moving up towards 400 again.

LATE NOTES: I can't prove it, but my suspicion is that a lot of people are going to lose a lot of money trying to "lock in rates" in this area -- even as the bond market rallies. Over recent months the frightened and impatient public has loaded up with every kind of money vehicle and bond fund. Why? The public has a voracious appetite for income.

Of course, from one standpoint that's understandable, and it really isn't fair to blame the public. After all, they do need the money, and I said long ago that INCOME is going to be the operative word during the "numbing nineties." So currently, with average stock yields below 3% and safe, short-term money market yields in the 5% area, the public is in a panic to capture any kind of decent return (note the numerous newspaper ads offering all kinds of wonderful returns via various combinations of bonds and bond funds).

My own inclination is to be patient. Things change, markets change, interest rates change. At this time I believe that the important thing for the average investor to do is -- NOT LOSE MONEY. This is the area -- with overvalued stocks and an overbought bond market -- where potential losses are created. Be careful here; do not act out of fear.

NEXT MAILING: Oct. 2